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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 429

HURLBUT W. SMITH,

Petitioner,

vs.

FRANK J. SHAUGHNESSY, COLLECTOR OF INTERNAL REVENUE OF THE UNITED STATES FOR THE TWENTY-FIRST DISTRICT OF NEW YORK.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit

BRIEF FOR PETITIONER

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Opinions Below

The opinion of the District Court (R. 25-28) is reported at 40 F. Supp. 19. The Per Curiam opinion of the Circuit Court of Appeals (R. 37) is reported at 128 F. (2d) 742.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on July 6, 1942 (R. 37). The Petition for Certiorari

was filed on September 29, 1942, and granted on November 9, 1942. (R. 38) The jurisdiction of this court is conferred by section 240(a) of the Judicial Code, as amended. (28 U. S. C. A. §347)

Question Presented

In 1937 the petitioner, as grantor, transferred securities in trust, the income from which was payable to his wife for life, and, upon her death, the principal was payable to the grantor, if living, and if not living then to such persons as the wife might by will appoint, or, in default of such testamentary disposition, then to her intestate successors. Is the grantor subject to gift tax upon anything other than the value of the life estate?

Statutes and Regulations Involved

The statutes involved are set forth in the Appendix, *infra*, p. 16.

Statement

The case was tried without a jury. (R. 1, 41) The District Court made findings of fact and conclusions of law. (R. 29-32)

On February 26, 1937, the petitioner, as grantor, pursuant to a trust indenture (R. 6-10) transferred to The Syracuse Trust Company 3,000 shares of convertible preferred stock of L. C. Smith & Corona Typewriters, Inc., in trust. The trustee was directed to pay over the net income from the fund quarterly to Gladys D. Smith, wife of the grantor, during her life and, upon her death, to pay over the principal of the trust to the grantor if he be then living. In the event the grantor predeceased the life beneficiary, then the trustee was directed upon her death to pay over the principal of the trust to such person or persons as she should by her will direct. In the event of the failure of the life beneficiary to make testamentary disposition of the

fund, then the trustee was directed to pay the same over to such person or persons as would take under the laws of New York, had the principal of the fund been owned outright by her and she had died intestate. (R. 29-30)

The value of the entire principal of the fund on the date of the creation of the trust was $570,937.50. (R. 31) On March 15, 1938, the petitioner filed a gift tax return in which he reported the full value of the principal of the trust fund. After deducting therefrom the exemption of $40,000 and the $5,000 exclusion, the Collector assessed a gift tax of $71,674.22 which the petitioner thereon paid. (R. 30) Three days later the petitioner filed a claim for the refund of the total amount of tax paid on the ground that the transfer in trust did not constitute a taxable gift. (R. 30) Upon rejection of that claim, this action was commenced. (R. 30-31)

On the date of the creation of the trust the value of the life interest of Gladys D. Smith was $322,433.53. (R. 31). No finding was made with respect to the value of the grantor's reversionary interest or of the interests of the possible remaindermen. The District Court held that the value of the life estate was subject to gift tax in the amount of $31,565.03. (R. 32) The court further held that the petitioner was not subject to gift tax upon anything other than the value of the life estate, and entered judgment in his favor for $40,109.19, being the balance of the tax paid on the return. (R. 32-33)

Upon the Government's appeal, it was contended that the District Court erred in not holding that the entire value of the securities transferred in trust, less only the value of the grantor's reversionary interest,[1] was subject to gift

[1] The Government's brief in the Circuit Court of Appeals contained the following note:

"The Bureau of Internal Revenue has advised that by actuarial computation, the value of the retained interest of the grantor in the instant case is $49,191.975 ($0.08616×$570,937.50)." [Br., p. 7]

tax. (R. 35) In a Per Curiam opinion, the Circuit Court of Appeals reversed on the authority of *Herzog* v. *Commissioner*, 116 F. (2d) 591 (C. C. A. 2d). (R. 37). The effect of the decision below is to impose a gift tax upon the entire value of the securities transferred in trust. The case is here on certiorari. (R. 38)

Specification of the Error to Be Urged

The Circuit Court of Appeals erred in holding that a gift tax was payable with respect to all or any part of the corpus of the trust fund.

Summary of Argument

The gift tax was imposed as a supplement to the estate tax, to tax transfers of property beyond the reach of the estate tax. The two taxes must be correlated. Correlation requires the application of one test: If the property interest is subject to the estate tax, then it is not subject to the gift tax. In other words, if the transfer *inter vivos* was "incomplete" for estate tax purposes, then the property interest is included in the gross estate and subject to the estate tax; and the gift tax does not apply. On the other hand, if the transfer of the property interest was "completed" *inter vivos*, then the gift tax is imposed and the estate tax does not apply.

If this reasonably simple test is applied, there will be no "overlapping"—except where Congress has specifically (and appropriately) provided for the imposition of both taxes. Instances of "overlapping" should be extended only by the Congress.

By the transfer in trust in 1937 the petitioner retained a reversionary interest which was prior in point of time to the ultimate disposition of the trust corpus, and which interest was terminable only by his death. The transfer was,

therefore, one intended to take effect in possession or enjoyment at or after his death, and the value of the corpus will be includible in the petitioner's gross estate at his death. The transfer was "incomplete" for estate tax purposes; and the gift tax does not apply.

Argument

(1) There was no completed gift of any part of the corpus of the Trust

Under *Helvering* v. *Hallock*, 309 U. S. 106, it is clear that upon the death of the grantor the then value of the corpus of this trust (less the value of the life estate)[2] will be includible in the decedent's gross estate for federal estate tax purposes as a transfer "intended to take effect in possession or enjoyment at or after death". (Sec. 811(c), I. R. C.) The reason for this result is that under the trust indenture the grantor has a reversionary interest similar to those in the *Hallock* case, *supra*, which, unless relinquished during his life, is terminable only by his death prior to that of the life tenant.

The question here is, to what extent a transfer subject to estate taxation at death by virtue of that which the decedent "retained" during his life is also subject to gift taxation at the time of the *inter vivos* transfer? Rephrased, the question is, whether *inter vivos* gifts of the type held "incomplete" in the *Hallock* case, for federal estate tax purposes, constitute "completed" gifts for federal gift tax purposes?

In *Estate of Sanford* v. *Commissioner*, 308 U. S. 39, this Court held that an *inter vivos* transfer of property was incomplete for gift tax purposes, where the donor reserved to

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[2] In its petition for certiorari in the *Hallock* case, the Government conceded that the value of the life interests was not a part of the gross estate. See *Central National Bank of Cleveland* v. *United States*, 94 Ct. Cl. 527, 544-545; 41 F. Supp. 239; *Estate of Horatio Gates Lloyd*, 47 B. T. A. 349, 357.

himself power to designate new beneficiaries other than himself.[3] Prior to that decision, this Court had held in *Porter* v. *Commissioner*, 288 U. S. 436, that the relinquishment of such a reserved power at death was a taxable transfer for estate tax purposes.

In deciding the *Sanford* case, this Court said:

> "We are concerned here with a question to which Congress has given no answer in the words of the statute, and it must be decided in conformity to the course of judicial decision applicable to a unified scheme of taxation of gifts whether made *inter vivos* or at death. * * *" [P. 48]
>
> "There is nothing in the language of the statute, and our attention has not been directed to anything in its legislative history to suggest that Congress had any purpose to tax gifts before the donor had fully parted with his interest in the property given, or that the test of the completeness of the taxed gift was to be any different from that to be applied in determining whether the donor has retained an interest such that it becomes subject to the estate tax upon its extinguishment at death. The gift tax was supplementary to the estate tax. The two are in *pari materia* and must be construed together. *Burnet v. Guggenheim, supra*, 286. An important, if not the main, purpose of the gift tax was to prevent or compensate for avoidance of death taxes by taxing the gifts of property *inter vivos* which, but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death." [P. 44] [4]

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[3] The Government was so uncertain concerning that issue that it took inconsistent positions and even argued both sides of the question in this Court. (Cf., *Rasquin* v. *Humphreys*, 308 U. S. 54.)

[4] The Court's conclusion is fully supported by its references to the legislative history of the gift tax provisions of the Revenue Acts of 1924 and 1932, which references read as follows:

> "The gift tax provisions to the Revenue Act of 1924 were added by amendments to the revenue bill introduced on the floor of the House and the Senate. Cong. Rec., Vol. 65, Part 3, pp. 3118-3119; Part

In view of the fact that, under the *Hallock* case, the value of the remainder interests in the instant case will be includible in the petitioner's gross estate for estate tax purposes, it is self-evident that under the "test of completeness" applied in the *Sanford* case the gift is incomplete for gift tax purposes.

The above-quoted language was applied in a case where the grantor reserved the power to designate new beneficiaries other than himself. We submit that the whole rationale of the *Sanford* case is equally applicable to the instant case where the grantor reserved the reversionary right to the entire corpus. In both, either death or a further *inter vivos* relinquishment of the reserved right is necessary before the grantor will have parted fully with the corpus. In both, the relinquishment at death will subject the value of the corpus to estate tax.

4, pp. 3170, 3171; Part 8, p. 8094. The sponsor of the amendment in both houses urged the adoption of the bill as a 'corollary' or as 'supplemental' to the estate tax. Cong. Rec., Vol. 65, Part 3, pp. 3119-3120, 3122; Part 4, p. 3172; Cong. Rec., Vol. 65, Part 8, pp. 8095, 8096.

"The gift tax of 1924 was repealed when Congress, concurrently with the enactment of § 302(c) of the Revenue Act of 1926, 44 Stat. 70, 125, 126, establishing a conclusive presumption that gifts within two years of death were made in contemplation of death and therefore subject to the estate tax. A gift tax was reenacted by § 501 of the Revenue Act of 1932, 47 Stat. 169, shortly after it was decided in *Heiner* v. *Donnan*, 285 U. S. 312, that the legislative enactment of such a presumption violated the Fifth Amendment." [308 U. S. 44, N. 1]

See also, S. Rept. 665, 72d Cong., 1st Sess. (1932) 40, wherein the gift tax provisions of the Revenue Act of 1932 are referred to as "an adjunct of the estate tax". With further reference to the purpose of the gift tax, the Report contains the following statement: "In short, the design is to impose a tax which measurably approaches the estate tax which would have been payable on the donor's death had the gifts not been made and the property given had constituted his estate at his death. The tax will reach gifts not reached, for one reason or another, by the estate tax." The Report of the Ways and Means Committee of the House contains identical statements (H. Rept. 708, 72d Cong., 1st Sess. (1932) 28-29).

In the *Sanford* case there was no possibility that the grantor would ever personally enjoy either the income or the corpus. In the instant case there is a possibility that the corpus will revert to the grantor. Indeed, the death of the life tenant prior to that of the grantor will alter the entire flow of benefits under the trust. However, distinctions of this kind between the particular type of right retained by a grantor, based upon the quantum of the reserved right or the economic control exercisable, only lead into the sophistries of property law rejected as unimportant in the *Hallock* case. Thus, in that case this Court, quoting from the dissent in *Helvering* v. *St. Louis Union Trust Co.*, 296 U. S. 39, said:

> "'Having in mind,' said the dissenters, 'the purpose of the statute and the breadth of its language it would seem to be of no consequence what particular conveyancers' device—what particular string—the decedent selected to hold in suspense the ultimate disposition of his property until the moment of his death. In determining whether a taxable transfer becomes complete only at death we look to substance, not to form . . . . *However we label the device it is but a means by which the gift is rendered incomplete until the donor's death.*' 296 U. S. at 47, 80 L. Ed. 34, 56 S. Ct. 74, 100 A. L. R. 1239. * * *" [P. 114—Italics ours]

The application of the *Sanford* case and the *Hallock* case to the present transfer is obvious. Here the grantor at the time of the creation of the trust made an unqualified gift of a life estate to his wife. The grantor has no power during his life to alter the enjoyment of that estate. It will be unaffected by his death. A completed gift of the life estate was, therefore, made which is admittedly subject to the gift tax. However, until the death of the grantor, or the prior relinquishment of his reversionary interest, the possession and enjoyment of the remainder interests are suspended.

No one can determine whether any actual gift of these interests has been made until the death of either the grantor or the life tenant. The remainder interests being thus subject to the reversionary right of the grantor were, as of the date of the creation of the trust, incomplete and, if not rendered complete until the death of the grantor, will then be included as a part of his estate for estate tax purposes. It follows that there was no complete gift of the remainders and, as to these, the gift tax is not applicable.

(2) The doctrine of the *Sanford* case should not be restricted to transfers in trust where the grantor reserved the power to change the beneficiaries.

After the decision of this Court in the *Hallock* case, The Tax Court of the United States consistently ruled that under the *Sanford* case there was no completed *inter vivos* gift where, as here, the grantor of a trust retained a reversionary interest contingent upon survival of the life tenant.[5]

Various circuit courts of appeal have reached a different result.[6]

The case of *Commissioner* v. *Marshall*, 125 F. (2d) 943 (C. C. A. 2d), is typical. There the Court attempted to distinguish the *Sanford* case, and to limit its application to cases where the grantor of a trust reserved "power to alter the flow of benefits" [P. 949]. It concluded that the value of contingent remainders is subject to gift tax, even though they will also be subject to estate tax. In reaching this

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[5] *Margaret White Marshall*, 43 B. T. A. 99; *Carl J. Schmidlapp*, 43 B. T. A. 829, 837-838; *William J. McCormack*, 43 B. T. A. 924, 929; *Morris Michel*, 43 B. T. A. 1036, 1038-1039.

[6] *Commissioner* v. *Marshall*, 125 F. (2d) 943 (C. C. A. 2d); *Commissioner* v. *McLean*, 127 F. (2d) 942 (C. C. A. 5th); *Helvering* v. *Robinette*, 129 F. (2d) 832 (C. C. A. 3d); Cf., *Herzog* v. *Commissioner*, 116 F. (2d) 591 (C. C. A. 2d).

result, the Court pointed to the fact that in certain instances gift and estate taxes necessarily overlap, and reasoned that because of this the *Sanford* case did not forbid the imposition of both gift and estate taxes upon a transfer where, as here, the grantor reserved a reversionary interest in the corpus of the trust.

The estate tax law contains a provision allowing a credit with respect to transfers previously subjected to the gift tax (Sec. 813 (a), I. R. C.). After referring to that provision, this Court in the *Sanford* case said:

> "The two taxes are thus not always mutually exclusive as in the case of gifts made in contemplation of death which are complete and taxable when made, and are also required to be included in the gross estate for purposes of the death tax. But § 322 is without application unless there is a gift *inter vivos* which is taxable independently of any requirement that it shall be included in the gross estate. * * *" [P. 45]

Obviously, this Court did not refer to gifts in contemplation of death as being the only ones with respect to which there might be both a gift and estate tax upon the same transfer.

To the extent that Congress expressly directs, there may, of course, be double taxation. (*Hellmich* v. *Hellman*, 276 U. S. 233) Thus, this Court in *Helvering* v. *Bullard*, 303 U. S. 297, upheld the imposition of an estate tax on an irrevocable transfer of a vested remainder subject to a life estate in the donor. Such a transfer would seem to be a completed gift. However, in the absence of a specific direction by Congress in the Joint Resolution of March 3, 1931 (46 Stat. 1516), such a transfer would not have been subject to the estate tax. (*May* v. *Heiner*, 281 U. S. 238)[7]

[7] In its brief in opposition (p. 9), the government suggested that gift and estate taxes overlap in the case of tenancies by the entirety. Congress has expressly directed that such tenancies shall be subject to the estate tax.

The difficulty with the reasoning of the courts in *Commissioner* v. *Marshall, supra*, and other similar cases is that the instances of overlapping relied upon were of statutory creation, wherein the estate tax—for the purpose of minimizing *inter vivos* tax avoidance transfers— was extended into the otherwise exclusive field of a gift tax. Cf. *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85. This statutory extension of the estate tax, however, does not support a like judicial extension of the gift tax into the field of the estate tax. The *Sanford* case recognizes the former, but forbids the latter. Nor is the provision in the estate tax law for a credit with respect to transfers previously subjected to the gift tax support for any such extension. (Sec. 813 (a), I. R. C.) The credit is the result of the statutory overlap of the estate tax into the gift tax—not the reason for it. It does not justify extending the gift tax by judicial decision to *inter vivos* transfers held by this Court to be incomplete for estate tax purposes.

It is certainly too clear for further argument that the rationale of the *Sanford* case is logically applicable to transfers where, as here, the grantor has reserved a reversionary interest sufficient to subject the contingent remainders to the estate tax. To limit that doctrine to the bare facts involved in the *Sanford* case, as suggested by the Court in *Commissioner* v. *Marshall, supra*, will destroy the correlation between the gift and estate taxes, and will necessarily extend the gift tax into the estate tax field already covered by the *Hallock* case.

The adoption of the Government's contention here will

(Sec. 811(3), I. R. C.) The extent to which the gift tax also applies has not yet been finally determined. The Tax Court of the United States has held that the creation of a tenancy by the entirety does not result in a taxable gift. (*William H. Hart*, 36 B. T. A. 1207) Two circuit courts of appeal have held otherwise. (*Lilly* v. *Smith*, 96 F. (2d) 341 (C. C. A. 7th); *Commissioner* v. *Hart*, 106 F. (2d) 869 (C. C. A. 3d)) If any overlap exists, it is because of the specific provisions of the estate tax law.

produce highly undesirable results from the standpoint of sound administration. It would result in double taxation, which this Court has said is never presumed. (*Moss* v. *Higgins*, 312 U. S. 443, 449) Furthermore, as a general principle, it would subject contingent donees to a secondary gift tax liability on property which they might never receive. The statute provides that the gift tax shall be paid by the donor (Sec. 1008 (a), I. R. C.), that it shall be a lien upon all property transferred, and that personal liability for payment extends to the donee. (Sec. 1009, I. R. C.) After referring to these provisions, this Court in *Burnet* v. *Guggenheim*, 288 U. S. 280, said:

> "A statute will be construed in such a way as to avoid unnecessary hardship when its meaning is uncertain. [Citing cases] Hardship there plainly is in exacting the immediate payment of a tax upon the value of the principal when nothing has been done to give assurance that any part of the principal will ever go to the donee. The statute is not aimed at every transfer of the legal title without consideration. Such a transfer there would be if the trustees were to hold for the use of the grantor. It is aimed at transfers of the title that have the quality of a gift, and a gift is not consummate until put beyond recall." [Pp. 285-286]

Finally, the adoption of the Government's contention here would necessitate resort, for gift tax purposes, to a wholly unrealistic valuation of remainder interests. (See *Commissioner* v. *McLean*, 120 F. (2d) 942 (C. C. A. 5th).) The trust device lends itself to the use of an infinite variety of contingencies, the happening of which may not only depend upon the prior death of a beneficiary or the grantor, but also upon the possibility of marriage, of future birth, etc. (See *Helvering* v. *Robinette*, 129 F. (2d) 832 (C. C. A. 3d).) The Circuit Court of Appeals in *Commissioner* v. *Marshall*, *supra*, approved the use of mortality

tables in a situation where only comparative life expectancies were involved. Even this was an extension of the use of such tables, not to measure the value of what the donor actually had received, but to measure the value of what he might never receive. (See, also, *Meierhof* v. *Higgins*, 129 F. (2d) 1002 (C. C. A. 2d).) Complicate the situation by the existence of a contingency based upon the possibility of marriage, and the problem becomes insurmountable. (See *Humes* v. *United States*, 276 U. S. 487.)

The rule of the *Sanford* case avoids these difficulties. Furthermore, it is comparatively simple to apply. The whole approach is from the standpoint of the estate tax. If the transfer is includible in the gross estate, there is no gift tax liability except where Congress has specifically created an overlap in the two taxes. The scope of the gift tax is thus clearly defined. Any broadening of this scope is a matter for the Congress.

The case of *Herzog* v. *Commissioner*, 116 F. (2d) 591 (C. C. A. 2d), on the authority of which the court below reversed the judgment of the District Court in the instant case (R. 37), is clearly distinguishable. There the grantor made a complete *inter vivos* disposition of the trust property without reserving any right other than a mere passive expectancy that the trustee might in his discretion distribute the trust income to him. As the court pointed out (p. 595), the trust corpus would not be includible in the gross estate of the grantor at his death. The imposition of the gift tax was, therefore, entirely consistent with the decision of this court in the *Sanford* case.

Conclusion

The petitioner made no completed gift of any part of the corpus of the trust in 1937. He is not, therefore, subject to gift tax upon anything other than the value of the life

estate. The judgment of the Circuit Court of Appeals is erroneous and should be reversed. The judgment of the District Court should be affirmed. If, contrary to the argument herein, this court concludes that the petitioner is subject to gift tax upon anything other than the value of the life estate, then, as conceded by the government in the court below, the value of the petitioner's reversionary interest should be excluded and the case should be remanded for the purpose of determining the value of that interest.

Respectfully submitted,

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APPENDIX

"Revenue Act of 1932, c. 209, 47 Stat. 169:

"SEC. 501. IMPOSITION OF TAX.

"(a) For the calendar year 1932 and each calendar year thereafter a tax, computed as provided in section 502, shall be imposed upon the transfer during such calendar year by any individual, resident or nonresident, of property by gift.

"(b) The tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible: * * *"

"SEC. 506. GIFTS MADE IN PROPERTY.

"If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift."

"SEC. 509. PAYMENT OF TAX.

"(a) TIME OF PAYMENT.—The tax imposed by this title shall be paid by the donor * * *"

"SEC. 510. LIEN FOR TAX.

"The tax imposed by this title shall be a lien upon all gifts made during the calendar year, for ten years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. * * *"